



**TESTIMONY OF
NATIONAL ASSOCIATION OF INDEPENDENT INSURERS**

**BEFORE
U.S. HOUSE COMMITTEE ON FINANCIAL SERVICES
SUBCOMMITTEE ON OVERSIGHT & INVESTIGATIONS**

AUGUST 1, 2001

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I am pleased to present the following statement on behalf of the National Association of Independent Insurers (NAII). We represent over 690 property/casualty insurance companies, and our members write approximately thirty-nine percent of the U.S. property/casualty insurance market. We want to commend the members of this subcommittee for holding this important hearing. Our overall perspective on this issue is that in some states excessive regulation does indeed impede the ability of consumers to have a wide array of choices in the insurance marketplace. The good news, however, is that other states take a more competitive approach with clear benefits for consumers, and they provide a road map for state-based reform.

THE “OVERREGULATION” ISSUE

Support for the ability to compete in a competitive marketplace has been the hallmark of NAII since its inception just following enactment of the McCarran Act. We are hearing from our members, however, unprecedented levels of concern regarding excessive regulation of rates and forms in some states and how it is hurting competition. There is significant diversity across the states as to how property/casualty rates and forms are regulated. In many states the regulatory framework balances the forces of competition with effective solvency and market conduct regulation. Competition serves as the best regulator of pricing and products. It is clear that some states do a better job than others of facilitating a competitive marketplace, which leads us to the subject of today’s hearing.

In some jurisdictions, excessive regulation has hindered competition, not only driving insurers out of the marketplace, but hurting consumers as well by limiting consumer choice, creating more cross subsidies, and increasing residual market

populations. Clearly there is growing consensus on this point as evidenced by this very proceeding, comments we hear from our members, academic studies, and our Association's own analyses.

THE NEW JERSEY EXPERIENCE

NAII members believe New Jersey is in fact a state where excessive regulation has restricted competition and thus had a negative impact on consumers. For many years NAII has been involved in industry-wide analyses of the problems in the New Jersey regulatory system and various attempts toward reform of it. As part of that continuing effort we recently conducted a specific analysis of the automobile insurance regulatory structure in particular, and the results confirmed and fleshed out in further detail the impediments to competition that currently exist in the state. New Jersey motorists pay the most in the country for their automobile insurance in part because they live in a high cost, very urbanized state and are exposed to the greatest amount of traffic density in the nation. They also incur the highest overall loss costs due to very expensive healthcare fees and the second most generous no-fault benefit package available in the country. These factors in large part account for why auto insurance costs more in New Jersey than in other states. However, it is the highly politicized and volatile regulatory system that makes it much more difficult for insurance companies to compete and operate in the marketplace. New Jersey's personal automobile insurance ten-year profitability results are among the worst in the country. The culmination of these regulatory factors and the impediments to competition they create have caused a number of insurers to exit the state over the years.

For three decades, the automobile insurance marketplace in New Jersey has been marked with significant problems resulting from adverse regulatory and legislative actions. Causes of the major problems over the years have included the following:

1. A no-fault law which provides significantly high medical benefits, yet still allows recovery for pain and suffering on a fault basis.
2. Severe limitations on the ability of insurers to terminate unprofitable business by way of cancellation/non-renewal.
3. Laws that restrict an insurer's ability to freely withdraw from the market and impose limits on the profits an insurer can earn in the state, both of which discourage new entrants and investment of new capital into New Jersey's auto insurance marketplace.
4. Unreasonable regulations and restrictions on rate adjustments in both the voluntary and residual markets.

That last point is of critical importance to our members. Under New Jersey law, companies are required to have rates approved through one of the most stringent and detailed rate regulatory systems in the nation. Contrary to a statute that says the commissioner needs to render a decision within 120 days from the time a hearing is requested, some rate filings have not received a final notice of action until a year or more after the filing was made.

The results of our analysis were confirmed by a study conducted by Professor John Worrall of Rutgers University whose findings were part of a Brookings Institution conference early this year. In his view, New Jersey is a state where it is incredibly difficult to get rate relief. The law has changed in the last two years, but rate regulation

has not: 29 of 32 rate filings were rejected, and three others got partial approval. Other requests for rate increases are pending.

Professor Worrall also concluded that the state probably has fewer firms writing business and less competition than it would under different regulatory schemes. The law and its administration have subjected drivers and insurers to unnecessary costs and burdened them with needless administration. It has limited the choices that would enable families with different resource levels to make insurance selections that are in their own best interests.

In NAII's analysis, we listed other specific factors that have contributed to the restraints on competition in New Jersey. These include:

1. Creation of a joint underwriting association (JUA) that later became the largest insolvent provider of automobile insurance in the country. By 1990 the JUA deficit had grown to \$3.1 billion. (Since that time the JUA has been eliminated and replaced with an assigned risk plan.)
2. An excess profits law that uses a questionable formula for determining excess profits and that is not needed if the competitive market were allowed to function properly.
3. Regulations that give the commission the authority to order an insurer planning to withdraw to continue renewing policies for up to six years from the time the withdrawal plan is approved.
4. Provisions that require insurers to surrender their licenses to sell all other lines of insurance if they abandon the state's auto insurance market.
5. Restrictions on rating that create further subsidizations through restrictions on territorial rating. Insurers cannot charge a rate in one rating territory that is "significantly disproportionate" to rates charged under a prior territorial rate

restriction law. Under that law, insureds cannot be charged more than 2.5 times the territorial base rate, nor more than 1.35 times the statewide average base rate.

6. A 1999 requirement that insurers provide an overall 15% reduction to their policyholders for rates renewed on or after March 22, 1999. Insurers were required to provide the rate cut before many of the cost reductions in the Act were implemented. Many of the reforms still have not been effectuated to this date. Part of that same reform law was aimed at fighting fraud, reducing over-utilization of PIP medical expense benefits and tightening the verbal threshold. These reforms, while positive, have not generated nearly the 15% rate reduction mandated by the law. There remains a great deal of uncertainty as to whether or not the change in the verbal threshold will result in any cost savings. The bottom line is that in the two plus years since the Act took effect, the cost savings that were supposed to be generated have not approached the 15% premium reduction.

NEW JERSEY: PROPOSALS FOR IMPROVEMENT

Some of the reforms recently implemented are a step in the right direction. Clearly, however, additional reform is needed to return New Jersey to a more competitive marketplace. This can be accomplished within the current state-based regulatory system, but substantial change in this state's regulatory structure and culture would be required, including but not limited to the following:

1. Repeal of the prior approval rating law and replacement with a more competitive use-and-file statute.

2. Complete repeal of state-mandated territorial restrictions. In essence these restrictions unfairly force some drivers to subsidize other drivers. Bad drivers and good drivers alike should be required to pay premiums commensurate with the risk they present.
3. Repeal of the take-all-comers law that requires auto insurers to extend coverage to all eligible applicants, even if the applicant does not meet the insurer's own underwriting criteria.
4. Repeal of restrictions on non-renewing bad drivers.
5. Further reform of the no-fault system.
6. Repeal of withdrawal law, which creates a process that can take up to six years to leave the New Jersey market.
7. Repeal of the excess profits law.
8. More consumer choice on benefit levels.

MASSACHUSETTS

As in New Jersey, in Massachusetts the insurance industry experiences excessive regulation of rates, forms and underwriting that has led to a decrease in choices available to consumers. By law, the insurance commissioner in Massachusetts actually sets the mandated rates that must be utilized by all insurers, and only limited deviations are allowed. This is done on an annual basis after the commissioner has made the necessary legal determination as to whether to use the rate-setting process. Under current law, the insurance commissioner has until December 15 to provide an auto insurance rate decision. Insurers then have until January 1 to convert the new mandated rates into premium computations for individual policy renewals in January. Because this window is

so small, many insurers are forced to issue estimated bills, with final bills being sent out later.

This onerous form of rate regulation, among the most extreme in the nation, severely limits the ability of insurers to react to market forces. The stringent anti-competitive regulatory system has had a chilling effect on competition. The number of companies offering personal automobile insurance in Massachusetts is one of the lowest in the country, with only 60 insurers offering personal automobile insurance coverage. In the 1980s, many of the larger national companies departed the state because of the extremes of the system and because of their high levels of losses.

Another significant related problem in Massachusetts lies in the tight regulation of the residual market. Any agent writing business through the residual market, known as the Commonwealth Automobile Reinsurers, has the ultimate right by statute to a contract with a carrier and to place any business with that carrier, with very few permissible underwriting criteria. Excessive regulation in the residual market, coupled with the same problem in the voluntary market, has left consumers in Massachusetts with fewer carriers from which they can choose.

There is further limitation of choice for Massachusetts consumers because the statutes also prescribe the precise form of coverage that must be made available to all, with the only variations being in the limits that insurers can offer to different customers. Carriers that want to include other coverages or offer other variations, even at lower rates are effectively precluded from doing so.

As in New Jersey the road to real solutions and more choices for consumers lies in a more competitive-based system, which would require comprehensive reform. Desirable

legislative changes would include a rating law with an approach grounded in competition such as a file-and-use law.

GOOD NEWS – BENEFITS FOR CONSUMERS IN MORE COMPETITIVE STATES

In contrast with New Jersey and Massachusetts, a number of other states around the country including but not limited to Illinois have more competitive-oriented regulatory systems, and the benefits for consumers as well as insurers are clear. There is a growing body of academic studies regarding more restrictive versus more competitive rating laws, and these studies conclude the benefits for consumers in states with competitive systems are very real. Examples of some of the latest academic evidence indicate:

1. “There is little or no evidence that prior approval on average has a material effect on average rates. ... Prior approval regulation is, however, reliably associated with lower availability of coverage. It is positively and significantly related to residual marketshares, even when states with reinsurance facilities or related residual market mechanisms and the largest residual marketshares are excluded from the comparison. Prior approval regulation also is reliably associated with greater volatility in loss ratios and expenditure growth rates after controlling for the influence of a number of other variables that could affect volatility.” (*From An Econometric Analysis of Insurance Rate Regulation*, Scott Harrington)
2. “The Illinois experience suggests that rate regulation for automobile insurance is unnecessary. Illinois has functioned without a rating law since 1971. Auto insurance is widely available from a large number of competitors. Rate changes are frequent, modest and appear to follow claim experience. Loss ratios and the size of the uninsured and residual market are in line with that in states that have

competitive rating laws. Thirty years of experience suggests that the automobile insurance market functions without regulation.” (*Insurance Price Deregulation: The Illinois Experience*, by Steven D’Arcy)

3. “From the mid-seventies through 1998, South Carolina intensively regulated auto insurance. Rate levels and rate structures were restricted, insurers underwriting discretion was limited and large cross-subsidies were channeled through its residual market. Contrary to political expectations, but consistent with economic theory, these regulatory measures worsened market conditions. ... South Carolina’s prior approval system was replaced by flex rating and restrictions on risk-based pricing and underwriting were substantially eased. The Reinsurance Facility and its large subsidies are being phased out and replaced temporarily by a JUA and ultimately by an assigned risk plan that will be required to charge adequate rates. ... With most of the reforms becoming effective in 1999, it is too soon to determine their ultimate outcome, but the early prognosis is positive. The number of insurers writing auto insurance has doubled with the implementation of the reforms. Many insurers have implemented more refined risk classification and pricing structures, as well as alternative policy options for consumers. It also appears that overall rate levels have continued to fall, possibly reflecting declining claims costs, as well as the easing of restrictions of risk-based pricing. Most importantly, the Facility is depopulating rapidly.” (*Auto Insurance Reform: Salvation in South Carolina*, by Martin F. Grace et al)

The conclusions of these and other academic scholars are consistent with the results of our Association’s own surveys and analyses. We want to emphasize, as pointed out above, that the success of more competitive systems is far from limited to Illinois. Other states such as Wisconsin have had more competitive systems for years and consumers have enjoyed the benefits of competition. It is also essential to note that more recently jurisdictions such as South Carolina have helped consumers through adoption of reforms that have facilitated a more competitive

environment. The point is there is compelling evidence that states can indeed make the transition from a more restrictive environment to a more competitive system, bringing with the changes substantial benefits for consumers, including greater availability and less subsidization.

In addition to reform of rate regulation, some states have taken specific positive action regarding reform of form filing requirements for certain risks. These include Arizona, Colorado, Michigan and Minnesota. States that have evolved their regulatory system to recognize the role played by competition show that state regulation works.

THE SOLUTION, PART I:

Last year the National Association of Insurance Commissioners (NAIC) produced a number of practical and operational suggestions that, if immediately adopted by individual insurance departments, would help speed the process of rate and product approval in the states. Those suggestions include elimination of desk-drawer rules, use of clear checklists regarding what must be in a filing, and specific timeframes for action by insurance departments on proposed rate and form changes. In our discussions with state regulatory officials as well as our members, we have seen that many states are beginning to move toward more efficient regulatory practices. Unfortunately, while there are some positive changes being made in some states on process and procedure, the need to deal with mindset and regulatory culture remains in several others. Changing this culture and mindset will take time. We urge Congress to give the states the opportunity to do just that. It is up to individual insurance departments to effectuate these operational efficiencies.

But we also hope that regulators will work with state public policymakers, as we are, to ultimately effectuate the public policy changes needed to assure that consumers are not denied the benefits of a more competitive environment.

THE SOLUTION, PART II: STATE LEGISLATION TOWARD MORE COMPETITIVE ENVIRONMENTS

While our organization supports competition, we do not call for elimination of all regulation. We suggest that states adopt laws that rely upon competition among insurers to determine insurance rates but also provide for regulatory intervention and consumer protection if a market is found not to be competitive. This also allows regulatory resources to be concentrated on solvency and market conduct.

There is some recent good news to report on the legislative front. Several states during their 2001 legislative sessions considered proposals for reform of the rate and/or form approval process. While there have been few enactments to date this year, it is good to see the states are indeed dealing with the issue.

We are also heartened by the very recent adoption by the National Conference of Insurance Legislators (NCOIL) of a model law that can truly help enhance competition and eliminate unnecessary and excessive regulation, for the benefit of consumers. The NCOIL model takes a use-and-file approach for personal automobile insurance. There

would still, however, be a prohibition on rates that are inadequate or unfairly discriminatory. Moreover, if a market is found not competitive, the insurance regulator would then have greater control over rate changes. We believe the NCOIL approach protects the consumer through a combination of competitive market forces and specific regulatory oversight. Of course, now the major challenge is to win adoption of competitive legislation along the lines of this model and the successful statutes in place in states like South Carolina, Illinois and Wisconsin. We hope that through additional discussion in state legislative forums such as NCOIL and NCSL, as well as the NAIC, more legislators and regulators will understand the need for competitive-based reforms. These reforms must be tailored to fit the nuances of each state.

CONCLUSION

NAII has long believed that state regulation of insurance is the most desirable means through which to achieve a competitive insurance marketplace for the benefit of the industry, regulators and consumers. A competitive marketplace insures consumers the lowest price, most diverse products, best service, and greatest number of insurance providers from which to select. Some states have indeed shown that state regulation can work in a manner that promotes a competitive environment. In order to achieve this goal,

the regulatory structures and principles followed in other states such as New Jersey and Massachusetts must change. Regulatory and legislative impediments that restrict market competition in these states and others must be eliminated.

NAII supports state regulation of insurance and opposes continued federal encroachment in the regulation in the business of insurance. As the debate over insurance regulation and reform continues, our organization will of course continue to examine other regulatory options as they are proposed. NAII recognizes that support within the industry for state regulation is dependent in large part on the states instituting meaningful reforms to modernize regulation for the benefit of consumers. NAII strongly urges Congress to give the states ample opportunity to improve the state regulatory system, to meet the concerns that have been expressed regarding states including New Jersey and Massachusetts. NAII is deeply committed to working with the NAIC, individual insurance commissioners, state legislators and all other interested parties on improvements to the state regulatory system. Thank you again for the opportunity to testify.

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NATIONAL ASSOCIATION OF INDEPENDENT INSURERS ANALYSIS OF STATE PRIVATE PASSENGER AUTO INSURANCE REGULATED MARKETS

Introduction

Each state has its own approach to regulating the property/casualty insurance business. The subtle differences between state regulation allows local policy makers to adjust regulatory needs to the nuances of the local market, including tort systems, population density, traffic and highway conditions, building codes and a host of other state-specific laws. Most state insurance departments have achieved with relative success a competitive market, enabling companies to operate in such a way that consumers benefit from fair insurance rates and greater product availability. A few states, including New Jersey, have enacted laws and regulations that make it difficult, if not impossible, for companies to operate effectively. This analysis focuses primarily on the condition of the New Jersey private passenger automobile insurance environment. The report also examines the South Carolina market, which was experiencing problems similar to those in New Jersey, but has recently improved market conditions thanks to changes in its regulatory system.

Highlights of this analysis include:

- On average, New Jersey motorists pay the most for their auto insurance because they live in a high-cost, very urbanized state and are exposed to the greatest amount of traffic density in the nation. They also incur the highest overall loss cost due to expensive health care fees and the second most generous no-fault benefit package available in the country. Moreover, there has been an increase in attorney utilization by New Jersey claimants, whereas claimants in other states have reduced their level of representation.
- The above variables coupled with a highly politicized and volatile regulatory system stifle competition and make it difficult for insurance companies to operate effectively in the state. New Jersey's personal auto insurance ten-year profitability results are among the worst compared to other states. These factors have caused a number of insurers to exit the state over the years.
- On the other hand, in light of recent auto insurance reform in South Carolina, favorable results are now being observed. These include rapid entry of new insurance companies into the state, a decline in average auto expenditures, and a drop in the auto residual market.

Although insurance regulation in New Jersey and several other states is in great need of reform, the majority of states have allowed free market forces to work well. Insurance consumers in most other states receive the benefits commonly associated with competitive markets, that is, insurance products and services available from alternative sources at the lowest possible prices.

New Jersey

For three decades, the personal auto insurance marketplace in New Jersey has been marked with significant problems resulting from adverse regulatory and legislative actions. Causes of the major problems over the years have included the following:

- a no-fault law which provides significantly high medical benefits,¹ yet maintains easy access to the courts for claims for pain and suffering;
- unreasonable regulations and restrictions on rate increases in both the voluntary and residual markets;
- severe limitations on the ability of insurers to terminate unprofitable business by way of cancellation and nonrenewal; and
- severe limitations on an insurer's ability to select the risks it will write in the state.

To allow for the current examination of each company's rates and practices, companies operating in New Jersey have been subject to some of the most stringent and detailed requirements in the nation. Companies are required to have their rates approved by the commissioner prior to their use, often after long and drawn out procedures lasting many months, if not years. As part of the prior approval procedure, many rate proposals are rigidly examined and challenged. Contrary to statute that says that the commissioner needs to render a decision within 120 days from the time a hearing is requested, some rate filings have not received a final notice by the commissioner until a year or more after the filing was made.² Often, the final rate changes are less than what was originally requested, in spite of supporting information.

Several specific legislative, regulatory and judicial actions affecting the New Jersey personal auto insurance market over the years are listed below. It is no wonder that this state has warranted such an unfavorable reputation in terms of the ability of insurers to do business here.

- The creation of a joint underwriting association (JUA) that was the largest *insolvent* provider of auto insurance in the country.³ In 1986, the deficit was estimated to be \$750 million, growing to \$3.1 billion by 1990.⁴ The JUA has since been eliminated.
- An "excess profits" law, that requires policyholder refunds if profits exceed a specified amount, but that prevents insurers from increasing surplus in a way needed to support the state's growing population.
- The enactment of the Fair Auto Insurance Reform Act in 1990, which allows "stranger" agents to place business with any insurance company. Under the "take-all-comers" law in the state, companies must accept the driver, regardless of how risky

¹ Until 1990, the level of medical benefits offered in New Jersey was unlimited.

² John D. Worrall, *Private Passenger Auto Insurance in New Jersey: A Three Decade Advert for Reform*, April 15, 2001

³ Report, "The New Jersey Automobile Full Insurance Underwriting Association: Recommended Solutions," submitted to New Jersey Governor Thomas H. Kean, September 1986.

⁴ A subsequent JUA-related action includes a 1990 proposal by Governor Jim Florio requiring insurers to pay \$1.4 billion to help satisfy the \$3.1 billion deficit in the state's JUA.

the individual is. The Act also imposed \$150 million in premium taxes over a two-year period and annual assessments of \$160 million over a seven-year period on insurers doing business in the state.

- The New Jersey Superior Court Appellate Division's decision to uphold a FAIR Act provision requiring insurers to surrender their licenses to sell all other lines of insurance if they abandon the state auto market.
- Regulations that give the commissioner the authority to order an insurer planning to withdraw to continue renewing policies for up to six years from the time the withdrawal plan is approved.
- A provision resulting in a subsidization in rates, whereby policyholders living in the suburban and rural areas of New Jersey are required to pay more to offset reductions given to their counterparts living in urban areas.
- The establishment of auto insurance Urban Enterprise Zones in 1997, requiring more insurers to write business in the cities.

Loss Experience

In order that insurance rates not be inadequate or excessive, they need to be actuarially sound, i.e., based on costs. In New Jersey, this condition is virtually impossible, as the level of regulation has been so oppressive that cost-based pricing simply cannot exist. For over a decade, the state has had the highest average premium in the nation, being 50%-60% higher than the countrywide norm. This should not be surprising, as New Jersey auto insurance policyholders:

- incur the highest overall auto insurance loss cost in the nation;⁵
- are exposed to the greatest number of vehicles per highway mile (ranked the highest in the nation,⁶ the traffic density in New Jersey is about 780 motor vehicles per square mile);
- continue to hire more attorneys when the level of representation has gone down countrywide; the increased level of attorney involvement in New Jersey has contributed to higher insurance costs (68% of New Jersey auto insurance claimants hired an attorney in 1997, up from 61% five years earlier);⁷
- incur very high hospital room charges (the 1999 average hospital inpatient service charges per admission in New Jersey are about 50% greater than the countrywide norm);⁸ and
- receive the second highest level of personal injury no-fault benefits (\$250,000) in the nation (second only to Michigan).

Since 1996, the state's bodily injury liability loss cost has gone up more than 20%⁹ (see Figure 1). If losses continue to rise and rates become more and more inadequate, insurers

⁵ *Fast Track Monitoring System, @1st Qtr. 2001*, quarterly report prepared jointly by the National Association of Independent Insurers and Insurance Services Office, Inc.

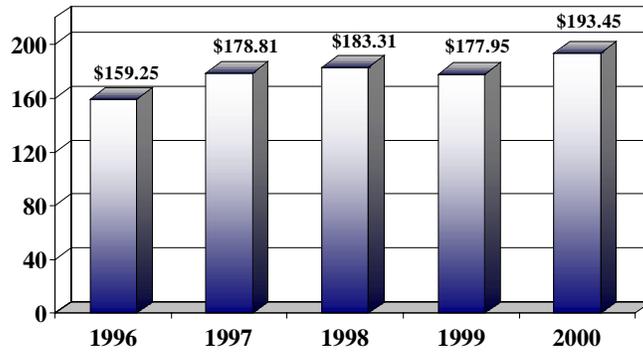
⁶ The ranking of states excludes the District of Columbia; the source of this information is the Federal Highway Administration and the Bureau of the Census.

⁷ Insurance Research Council, *Injuries in Auto Accidents: An Analysis of Auto Insurance Claims, 1999*

⁸ Mutual of Omaha Insurance Company, *Current Trends in Health Care Costs and Utilization*

will not be able to sustain their operations in the state. It is no wonder that State Farm Indemnity Company, American International Insurance Company of New Jersey and other companies have made recent announcements to withdraw.

Figure 1
New Jersey
Bodily Injury Liability Loss Cost



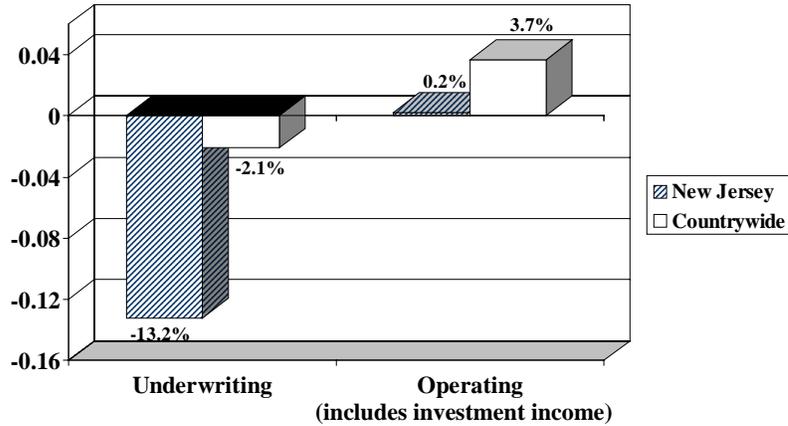
Source: Fast Track Monitoring System

Profitability

The deteriorating economics of New Jersey's underwriting can also be demonstrated by examining profit figures. Over the years, the state's private passenger auto insurance companies have fared poorly in terms of profitability, both on an underwriting basis and after investment income is taken into account. While the industry has realized a profit during some years, it does not come close to making up for the overall losses incurred by insurers in this state. Below in Figure 2 is an illustration comparing the ten-year average profitability results, from 1990-1999, for New Jersey and countrywide from both the underwriting and investment operations.

⁹ Fast Track Monitoring System, @ 1st Qtr. 2001

Figure 2
New Jersey vs. Countrywide
Personal Auto Profitability
(as a % of earned premium)
1990-1999 Combined



Source: National Association of Insurance Commissioners, Profitability by Line By State, (liability and physical damage combined)

During the ten-year span, private passenger auto writers in New Jersey accrued a total underwriting loss of 13.2% of earned premium, or \$5.3 billion.¹⁰ This figure reflects both liability and physical damage coverages. While underwriting results nationally have resulted in a loss, too, the percentage is not as low as in New Jersey. And after investment income is included, New Jersey auto insurers barely broke even over the past decade, while companies writing in the entire United States made only a small operating profit.

Competition in New Jersey

Sales concentration ratios for the leading firms are traditionally used as an appropriate measurement of market power. Theoretically, if one or a few firms control unreasonably large shares of the market, prices and availability might be unduly influenced by the actions of the leading firms. The aggregate market share of the top four auto insurance companies in New Jersey jumped fifteen points from 1998 to 2000 (from 33.5% to 48.2%); similarly, the aggregate market share of the top eight insurers increased 10 points over the same period (from 50.5% to 60.8%).¹¹ Such growth indicates that the largest writers are having greater influence on the market and there is a tendency toward less competition among the total number of auto insurance companies in the state.

¹⁰ National Association of Insurance Commissioners, *Profitability By Line By State*

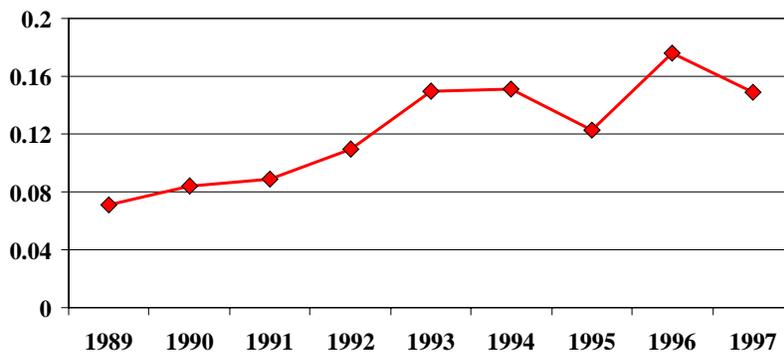
¹¹ National Association of Insurance Commissioners database, Thomson Financial Insurance Solutions

This is also seen to be the case in Massachusetts, another state with onerous regulations. Here, the law requires the state commissioner to set the auto insurance rates. Like New Jersey, Massachusetts is high cost and very urbanized, which contributes to the high price paid by policyholders. This state, too, has a poorly structured regulatory system that has discouraged new companies from entering the market. The number of companies offering personal auto insurance in Massachusetts is one of the lowest in the country, much lower than elsewhere. Only 60 insurers offer personal auto insurance here;¹² given the state's number of drivers, this quantity is remarkably low and very disconcerting.

Uninsured Motorist Population

1997 auto insurance reform legislation in New Jersey established urban enterprise zones to alleviate the problem of uninsured motorists in the state (i.e., primarily in the inner cities). Having had one of the lowest uninsured driver populations in the nation at one time, New Jersey has in recent years been faced with an ongoing problem of drivers without liability coverage. In 1989, its share of uninsured motorists was only 7.1%; latest data for 1997 show that this level has more than doubled to 14.9%, rising to nearly 18.0% in 1996.¹³ It is too soon to tell whether the creation of urban enterprise zones is a long-term solution to the problem.

Figure 3
New Jersey
Estimated Uninsured Motorist Population



Source: Insurance Research Council

South Carolina

South Carolina had a regulatory structure that, like New Jersey's current structure, proved difficult for insurers. That has changed. In 1999, South Carolina auto insurance reform measures became effective pursuant to a 1997 enactment; one of these changes was a

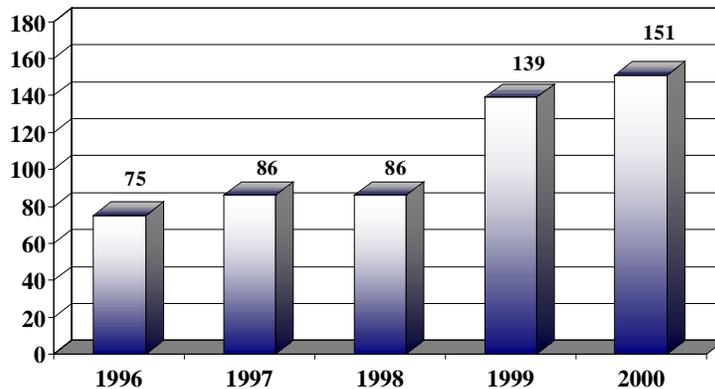
¹² Ibid.

¹³ Insurance Research Council, *Uninsured Motorists*, 2000

conversion in the rating law from a prior approval system to a flex-rating system.¹⁴ Other favorable changes included elimination of restrictions on territorial rating differentials and significant residual market reform. Some favorable observations have resulted since the change in law; these include the following:

- On average, South Carolina motorists paid 12.2% less for auto insurance in 1999 compared to the previous year. In 1998, the average annual auto insurance expenditure in this state was \$655.33, while in 1999, the amount dropped to \$573.31.¹⁵
- The number of private passenger auto insurers has more than doubled, resulting in a more competitive market for consumers. In 1996, there were 75 auto writers in South Carolina; four years later, this figure has now surpassed 150 (see Figure 4).¹⁶

Figure 4
Number of Companies
Writing Personal Automobile
in South Carolina



Source: National Association of Insurance Commissioners

- The South Carolina personal auto industry concentration index is now in the unconcentrated range, indicating improved competition among insurers. This index is based on market shares of all the writers and is used to measure the level of competition in the market.
- According to the Center for Risk Management and Insurance Research Department at Georgia State University, new insurers in the South Carolina market are opting to

¹⁴ Under a flex-rating system, companies may file and use their new rates without waiting for approval from the commissioner if increases or decreases fall within a specified band. Rate changes outside the band still require prior approval.

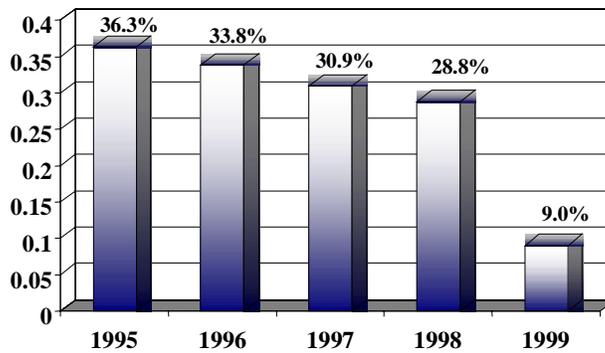
¹⁵ National Association of Insurance Commissioners, *State Average Expenditures & Premiums for Personal Automotive Insurance*

¹⁶ National Association of Insurance Commissioners database, Thomson Financial Insurance Solutions

write homeowners insurance because of the economics involved in marketing multiple personal lines insurance products. This has a highly beneficial effect for South Carolina residents as the state has a high hurricane risk.¹⁷

- Before auto reform was enacted, South Carolina's residual market share was mostly in the 30%-40% range. Following the change in the rating law, the level of policies in the residual market plunged to 9.0%.¹⁸

Figure 5
South Carolina
Residual Market Share
Private Passenger Automobile



Source: South Carolina Department of Insurance

- From 1998 to 1999 (effective year of reform) the number of vehicles insured in the residual market dropped 70 percent while those in the voluntary market increased 36 percent, clearly showing the absorption of risk by the South Carolina voluntary auto insurance market.¹⁹

The National Association of Independent Insurers is a trade association of more than 690 property/casualty insurance companies. NAII members represent approximately 45% of the personal auto market in the nation.

¹⁷ *Auto Insurance Reform: Salvation in South Carolina*, Center for Risk Management and Insurance Research, Georgia State University, January 15, 2001, Martin Grace, Robert Klein & Richard Phillips

¹⁸ South Carolina Department of Insurance

¹⁹ AIPSO, *AIPSO Circular*, Circular Number BOD 01-05 RMC 01-10, May 15, 2001